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MiFID II for buy side firms – getting to the starting line

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MiFID II readiness – a cause for concern?

“We are very conscious of the obligations imposed by MiFID II on firms. Our objective has been to help firms put in place the foundations for MiFID II and to be ready for day one on 3 January 2018...”

I know some of you want to know what our enforcement approach will be for firms that have not completely transitioned in time for 3 January 2018.

*As always, we intend to act proportionately. In this context, this means we will not take a strict liability approach especially given the size, complexity and magnitude of the changes that are required to be in place. We are very aware of how much work many firms have been engaged in for a very long time now in re-tooling and preparing for next year. This means **we have no intention of taking enforcement action against firms for not meeting all requirements straight away where there is evidence they have taken sufficient steps to meet the new obligations** by the start-date, 3 January 2018.*

*Many firms that have been working well to prepare for next year and they should feel assured and confident that they can continue to work with us to meet the starting line. At the same time, **we cannot create a floor for compliance below the required MiFID II standards and so our disposition is likely to be different where firms have made no real or genuine attempt to be ready or where key obligations are deliberately flouted.**”*

Speech by Mark Steward, Director of Enforcement and Market Oversight at the FCA, delivered at the AFME European Compliance and Legal Conference 2017

Agenda today

MiFID II overview, EU and UK implementation, scope and potential impact areas

- Investor Protection
 - Product Governance
 - Client disclosures and reports
 - Suitability
 - Appropriateness
 - Inducements
 - Research
 - Client categorisation
 - CASS
 - Recording of telephone conversations / electronic communications
- Organisation
 - Corporate governance
 - Conflicts of interest and remuneration
 - Knowledge and competence
 - Complaints
 - Outsourcing
- Markets
 - Best execution
 - Transaction reporting
 - Post trade transparency

MiFID II – overview

- The current Markets in Financial Instruments Directive (“**MiFID**”) has been in force in the EU since 1 November 2007
- Following a review of MiFID carried out by the European Commission, a new regime under MiFID II will apply from 3 January 2018. MiFID II contains new EU-wide rules governing investment firms, trading venues and market structures, as well as third-country firms that provide investment services or activities in the EU
- MiFID II comprises:

The MiFID II Directive (2014/65/EU)

EU Member States must have adopted and published by 3 July 2017 the measures transposing this into national law. Will apply from 3 January 2018.

<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065>

The Markets in Financial Instruments Regulation (Regulation 600/2014) (“**MiFIR**”)

MiFIR, as a regulation, will apply directly in Member States from 3 January 2018.

<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0600>

MiFID II – EU implementing measures

- The following provide rules/guidance for the MiFID II regime, in addition to the Level 1 texts of MiFID II/MiFIR

Level 2 measures

- A huge number of Delegated Acts, Regulatory Technical Standards, Implementing Technical Standards and Implementing Acts under MiFID II/MiFIR set out detailed provisions on the MiFID II/MiFIR requirements, for example
 - Best execution
 - Suitability assessments and reports
 - Disclosure of costs and charges
 - Organisational requirements
 - Product governance
 - Transaction reporting

Level 3 measures

- ESMA Guidelines
- ESMA Q&As
- These are not consulted on and provide guidance on many areas of MiFID II e.g. investor protection topics, product governance, transaction reporting – non binding, ‘comply or explain’ approach

MiFID II – UK implementation

- MiFID II will be implemented in the UK through amendments to the Financial Services and Markets Act 2000 (“**FSMA**”) and a combination of secondary legislation and FCA/PRA Rules
 - **HM Treasury** published a policy statement in February 2017 on transposing MiFID II into national law, with three new statutory instruments. Topics covered include structured deposits, third countries, OTFs
 - **PRA** issued two key policy statements - PS 29/16 on algorithmic trading/DEA and PS 9/17 on operating an OTF and new financial instruments/regulated activities
 - **FCA** issued six consultation papers in 2015-2017, setting out its draft new rules/guidance in the FCA Handbook to implement the various aspects of MiFID II
 - CP 15/43 (markets, transparency, market data)
 - CP 16/19 (commodity derivatives, SYSC, CASS)
 - CP 16/29 (COBS, product governance, PERG)
 - CP 16/43 (specialist regimes, market data, fees)
 - CP 17/8 (specialist regimes, including rules for Occupational Pension Scheme firms)
 - CP 17/19 (residual matters)
 - **FCA** published its first policy statement on 31 March 2017 (PS 17/5), setting out finalised FCA Rules/guidance on markets, transparency, SYSC, remuneration. Second policy statement published in July 2017 (PS 17/14), covering all other areas (i.e. conduct rules)
 - Website guidance, applications and notifications guide user guide, FCA speeches etc.

MiFID II – scope

- In direct scope, any MiFID investment firm and any EU credit institution providing investment services
- Out of (direct) scope
 - Article 3 MiFID exempt firms such as certain IFAs (although subject to some equivalent rules)
 - Alternative Investment Fund Managers and UCITS Managers (some equivalent rules e.g. for standalone portfolio management, research, best execution etc. but not transaction reporting)
 - Non EEA entities (although UK/EU branches subject to generally equivalent rules)
- Worth remembering:
 - that a number of detailed rules under MiFID II have reduced or no application and/or opt-outs, sometimes subject to client consent, where a firm is dealing with professional clients or eligible counterparties
 - MiFID II has many indirect impacts on buy side through its major impact on sell-side i.e. trading venues and broker dealers under the new market structure and transparency regime

MiFID II – potential impact areas for buy side

Business area/procedure/process	Relevant MiFID II requirements
Investment advisory and management services	Suitability; inducements and research; conflicts of interest; annual reviews; client communications and reports
Order execution	Appropriateness; best execution arrangements and policies; annual publication of top five brokers/entities/venues used and execution quality; client reports; recording of order information
Client communications, reports and statements	Client categorisation; costs and charges disclosures; 10% value/portfolio decrease; client reports and statements; repapering/outreach
Manufacture and distribution of financial instruments/products/services (i.e. almost anyone in the sector)	Product governance regime
Market reporting	Transaction reporting and post trade transparency
Organisation	Updates to policies and procedures, e.g. conflicts of interest; recording of telephone conversations/electronic communications; record-keeping; complaints handling; staff knowledge and competency
Outsourcing	Outsourcing arrangements and agreements; territorial impacts

Product Governance – delivering investor protection



Product governance (1)

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 13 and 19 • FCA “Responsibilities of Providers and Distributors for the Fair Treatment of Customers” (“RPPD”) guidance
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 16 and 24; Delegated Directive (EU) 2017/593 Art. 9 and 10 • ESMA guidelines: https://www.esma.europa.eu/sites/default/files/library/esma35-43-620_report_on_guidelines_on_product_governance.pdf • FCA Handbook, Product Intervention and Product Governance Sourcebook (“PROD”)
What are the changes?	<ul style="list-style-type: none"> • New EU-wide product governance and distribution regime, with detailed obligations applying to product manufacturers and distributors. Requirements apply to financial instruments <u>and</u> investment services. MiFID II requirements broadly equivalent to existing UK guidance but now will apply as rules and some requirements more extensive • The FCA defines “distribute” broadly, as offering, recommending or selling an investment or providing an investment service to a client. “Manufacture” means creating, developing, issuing or designing an investment • Distributor requirements include ensuring the firm obtains sufficient information to understand the investments it offers; having adequate procedures for determining the target market; ensuring staff have expertise to understand characteristics of products; ensuring sufficient compliance and senior management oversight; covering product governance in compliance reports; and reporting to product manufacturers with sales data etc.

Product governance (2)

REQUIREMENTS	
What are the changes?	<ul style="list-style-type: none">• Manufacturer requirements include having in place a proper governance process for the development and periodic review of the product; identifying with sufficient granularity the target market of end clients with whose needs, characteristic and objectives the product is compatible; undertaking product testing (including in negative conditions) to assess the risk of poor investor outcomes; considering the charging structure; identifying crucial events that would affect the potential risk or return expectations; having appropriate information sharing arrangements with other distributors (if applicable) etc.
What are the key impacts?	<ul style="list-style-type: none">• Firms will need to review their product governance arrangements, product literature and any distribution agreements to ensure they meet the requirements for distributors and manufacturers

Product governance

- PROD applies as rules to MiFID firms and guidance for non-MiFID firms
- Regime will apply
 - in respect of all clients and all products
 - in a way that is *appropriate* and *proportionate*
- FCA and ESMA have significant product intervention powers, including powers to make rules to prohibit entering into certain agreements
 - local regulators have remit to intervene

Manufacturers & distributors

- What is a product manufacturer
 - “manufacturing financial instruments” encompasses the creation, development, issuance and/or design of financial instruments
 - overlap with PRIIPs?

- What is a distributor
 - “distribute” encompasses offering, recommending or selling an investment or providing an investment service to a client

- Firms may be both a manufacturer and a distributor

Manufacturer obligations

- Manufacturer must
 - have product approval process in place
 - understand the product offered/recommended
 - specify target market (with sufficient granularity), category of end clients, relevant risks, distribution strategy that is consistent with the target market
 - ensure that financial instrument is designed to meet needs of identified target market
 - take reasonable steps to ensure distribution to identified target market
 - stress test and regularly review and assess if product remains consistent with need of target market and distribution strategy
 - manage conflicts of interest, including in relation to remuneration

- Where there is collaboration amongst manufacturers must be a written agreement setting out mutual responsibilities

Distributor obligations

- Distributors must
 - use own information and information provided by manufacturer to identify client needs, target market and distribution strategy
 - distribute financial instrument only if it is in the client's best interest
 - undertake regular review process to assess if financial instrument and distribution strategy remain appropriate
 - provide feedback to manufacturer

- Distributor obligations are distinct from and in addition to suitability and appropriateness assessments

Distribution chain

- Information must be shared up and down the chain

- Final Distributor
 - has ultimate responsibility to meet obligations

- Intermediate Distributor
 - must pass on information from manufacturer to final distributor
 - enable final distributor to obtain information from manufacturer
 - apply manufacturer obligation “as relevant”

Governance arrangements

- Applies to both manufacturers and distributors
 - relevant staff
 - have necessary expertise or receive training
 - management body
 - have effective control over process
 - compliance function
 - oversee development and periodic review, detect risk

Target market (1)

- “*Considerations of target market factors should permeate all aspects of product development and distribution...*”

- Manufacturers
 - need to identify a *potential* target market
 - to do so, must use a prescribed list of categories: type of client; knowledge and experience; financial situation with a focus on ability to bear losses; risk tolerance; and clients’ objectives and needs
 - nature of the investment product an important factor
 - distribution strategy must be consistent with identified target market

- Distributors
 - define actual target market – needs to sit and be considered alongside other product governance processes
 - consider same list of categories – but base on actual knowledge and information of client base
 - define own distribution strategy

Target market (2)

- Both manufacturers and distributors must undertake a regular review to ensure products/services reaching the right target market
 - does the product remain consistent with needs?
 - does the distribution strategy remain appropriate?

- Both manufacturers and distributors need to consider “negative market”
 - those for whom the produce is incompatible

- Other considerations
 - distribution of products manufactured by non-MiFID II entities
 - distribution of products manufactured before 3 January 2018

European MiFID II template

- Distributors starting to send out EMT to manufacturers
- Aim of the EMT:
 - to standardise certain of the data required by certain distributors to deliver obligations under MiFID II
 - includes target markets, distribution strategy, costs and charges
- Not compulsory
 - certain manufacturers face challenges with producing some of the data and are reliant on 3rd parties to assist
- Timing
 - challenge for manufacturers to produce data in time for distributors in time for 3 January
- Costs
 - can manufacturers take these from the funds?

Client disclosures and reports (1)

REQUIREMENTS

Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 19(3),(8); MiFID Implementing Directive Art. 33, 40 • COBS 2, 4, 6, 16
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 24(4), 25; • Delegated Regulation (EU) 2017/565, Art. 50, 59-63, Annexes II and IV, Recitals 74-83 • COBS 2.2A, COBS 6.1-A.2.8 EU, COBS 16A.2.1 EU
What are the changes?	<p>Costs and charges disclosures</p> <ul style="list-style-type: none"> • New, granular requirements for the costs and charges that must be disclosed to clients (i.e. retail and professional clients and eligible counterparties (“ECPs”)) • Ex-ante (point of sale) and ex-post (annually for ongoing client relationships) disclosures required, aggregating all costs and associated charges: (i) for the investment/ancillary services provided; and (ii) associated with the manufacturing and managing of the financial instruments (where firm recommends or markets the financial instruments) • Aggregated costs and charges must be totalled and expressed as a cash amount and on a percentage basis • Ex-ante disclosures can be based on an assumed investment amount and must use actually incurred costs as a proxy for expected costs, or reasonable estimates • Must also provide an illustration (both ex-ante and ex-post) showing the cumulative effect of costs on return when providing investment services • Some limitations to disclosures (e.g. on illustrations) can be agreed with professional clients and ECPs but <u>not</u> where financial instrument concerned has a derivative embedded and, for professional clients, where investment advice or portfolio management services are provided • If a client requests, firm must be able to provide to the client an itemised breakdown of costs and charges (IA has produced draft guidance here)

Client disclosures and reports (2)

REQUIREMENTS

<p>What are the changes?</p>	<p>Execution of orders</p> <ul style="list-style-type: none"> • Reporting requirements extended to professional clients and ECPs • Minor changes to records required to be kept of client orders received, decisions taken to deal and transactions (as listed in Annex IV to Delegated Regulation (EU) 2017/565). <p>Notification of 10% drop in portfolio value when managing or in respect of leveraged financial instruments/contingent liability transactions</p> <ul style="list-style-type: none"> • When providing portfolio management services, must inform the client where the value of the portfolio depreciates by 10% no later than the end of the business day in which the threshold is exceeded (or the next business day if applicable) <p>Statements of client money/assets</p> <ul style="list-style-type: none"> • Statements must be provided quarterly
<p>What are the key impacts?</p>	<ul style="list-style-type: none"> • Need to develop compliant costs and charges disclosures and, unless otherwise agreed with professional clients and ECPs, illustrations • Need process for gathering required information on costs; may require liaising with third party product manufacturers/providers • Need to update record-keeping procedures for client orders received • Implement process for notifying clients of 10% drop in value of portfolio or contingent liability transactions • Provide statements of client money/assets quarterly • Update relevant policies and client documentation to refer to these disclosures/notifications

Client categorisation (1)

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Implementing Directive Art. 29(1),(4),(5) and (6) • COBS 3 • COBS 8
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 30(1), Recital 104; Annex II • COBS 3 and COBS 8
What are the changes?	<p>Minor changes to client categorisation:</p> <ul style="list-style-type: none"> • Local authorities will be classified as retail clients by default (whereas previously could generally be professional clients). May only be opted-up to (elective) professional client status where prescribed qualitative and quantitative tests are met <ul style="list-style-type: none"> • Retail categorisation will also apply to local authorities who act as pension fund administrators or as treasury managers • Categorisation and opt-up criteria must be applied separately to each business line (with assets of the pension fund not included in the quantitative test where local authority acts as treasury manager, and with quantitative criteria being applied only to pension fund assets where local authority acts as administrator) • National/regional governments/public bodies – only those that manage public debt at national or regional level can be categorised as a per se professional client • Elective professional clients will no longer be able to opt-up to eligible counterparty • Client information requirements (i.e. on risks, costs and charges) and client reporting requirements will also apply to eligible counterparties • Requirement to enter into a written agreement with clients is extended to professional clients

Client categorisation (2)

REQUIREMENTS

What are the key impacts?

- Need to review and update any client categorisation processes/procedures, including in relation to local authorities and local authority pension funds
- If applicable, need to review any local authority and national/regional government or public body clients to check they meet the new rules
- If applicable, review treatment of ECPs and provide them with required information
- If applicable, ensure have written agreement with professional clients

Suitability

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 19(4) • COBS 9
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 25 • Delegated Regulation (EU) 2017/565 Art. 54-55 • COBS 9A
What are the changes?	<p>Suitability requirements expanded and clarified under MiFID II (no fundamental new requirements)</p> <ul style="list-style-type: none"> • Must assess suitability for all decisions/advice on whether to trade (i.e. buy/hold/sell) and prepare suitability report in writing • Must assess suitability of overall bundled package where applicable • When advice or discretionary management involves switching investments, must analyse costs and benefits of the switch • When providing ongoing advice/discretionary management, must maintain adequate and up-to-date information about client, as necessary to understand the essential facts about the client and have a “reasonable basis” for determining suitability of a transaction; as is the case today, may assume that a professional client has the necessary experience and knowledge to understand the risks involved • Must take reasonable steps to ensure information on clients is “reliable” • Periodic suitability reports can merely cover changes in service / instruments / client’s circumstances but need to demonstrate how the portfolio meets requirements
What are the key impacts?	<ul style="list-style-type: none"> • Review suitability procedures in advice and discretionary management services for compliance with MiFID II requirements • Issuing suitability reports in writing for all products and for each piece of advice is likely to be burdensome

Appropriateness

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 19 • COBS 10
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 25(3-4); Delegated Regulation (EU) 2017/565 Art. 55-57 • ESMA Guidelines: https://www.esma.europa.eu/file/15443/download?token=-HdmLkAl • COBS 10A
What are the changes?	<ul style="list-style-type: none"> • As today, firms may assume that professional client has the necessary knowledge and experience to assess the risks • Under MiFID II, appropriateness requirements apply to an extended range of products (“complex” products). Narrower range of execution-only (“non-complex”) products • New definition of “non-complex” products, which makes the following complex products <ul style="list-style-type: none"> ➤ Shares in structured UCITS and non-UCITS funds ➤ Shares that embed a derivative ➤ Bonds not admitted to trading on a RM or equivalent third-country market or a MTF ➤ Bonds or other forms of securitised debt, and money market instruments with a structure that makes it difficult for the client to understand the risk involved ➤ Structured deposits with a structure that makes it difficult for the client to understand the risk of return or the cost of exiting the product before term (otherwise, structured products are now execution-only) • ESMA Guidelines set out indicative examples of complex debt instruments and structured deposits • New specific record-keeping obligation for appropriateness assessments (including the result of the assessment and any warning given) but only relevant for retail clients
What are the key impacts?	<ul style="list-style-type: none"> • How does one map what is complex/non-complex – will manufacturers/flag this going forward so that differing views on same product are not taken across the market?

Inducements (1)

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 19(1); MiFID Implementing Directive Art. 26 • COBS 2.3, 11.6
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 24; • Delegated Directive (EU) 2017/593, Art. 11, 13 • COBS 2.3A, 2.3B
What are the changes?	<p>MiFID II imposes further restrictions on the receipt/provision of inducements by firms in relation to investment services</p> <ul style="list-style-type: none"> • New conditions that must be satisfied in order for inducements to be permitted, e.g. inducement must be justified by the provision of an additional/higher level service to the client, proportionate to the level of inducement received • More prescriptive disclosure requirements to clients in relation to inducements, e.g. amount or method of calculation should be disclosed; non-monetary benefits must be priced and disclosed separately • In the UK, advisers and portfolio managers prohibited from accepting and retaining any inducements from third parties in relation to services for retail clients, save for “acceptable minor non-monetary benefits” • In the UK, independent advisers and portfolio managers prohibited from accepting and retaining any inducements from third parties in relation to services for professional clients, save for “acceptable minor non-monetary benefits”

Inducements (2)

REQUIREMENTS	
What are the changes?	<p>Inducements and research:</p> <ul style="list-style-type: none"> • MiFID introduces new restrictions on the receipt of third party research • Effectively, third party research is deemed not to constitute an inducement and may be received by portfolio managers or firms providing investment/ancillary services if paid <ul style="list-style-type: none"> • out of their own resources; or • from a separate 'research payment account' (RPA) • The RPA must be funded by a specific research charge agreed with the client, based on a research budget not linked to the volume/value of transactions executed for the client • The quality of research purchased must be assessed regularly based on robust quality criteria and ability to contribute to better investment decisions • Client disclosures are also required • The research charge can be collected alongside a transaction commission provided it is identified separately • Trial periods may be acceptable non-monetary benefits but subject to strict conditions • Some exemptions for collective portfolio management firms with core investment policy in non financial instruments (e.g. real estate, infrastructure, private equity)
What are the key impacts?	<ul style="list-style-type: none"> • Need to ensure compliance with the stricter rules on the receipt/provision of inducements – determine what policy will be • Need to update client (and potentially fund) documentation and disclosures accordingly • Significant impact on investment managers that use research – how will they pay for this going forward? • Even if firms fund research themselves from P&L, will still need policy on what they can accept for free (e.g. sales desk commentary) and how they categorise/price/value research (and corporate access) • Delegation models and impact on non-EEA managers/brokers

Recording of telephone conversations and electronic communications

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Implementing Directive Art 51(4) • COBS 11.8
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 3(2)(c), 16(7); Delegated Regulation (EU) 2017/565 Art. 76 • SYSC 10A
What are the changes?	<p>MiFID II imposes a new EU-wide harmonised regime for recording telephone conversations / electronic communications. UK already has a taping regime, but requirements expanded:</p> <ul style="list-style-type: none"> • MiFID II regime applies to all MiFID financial instruments (not qualifying investments) • Must record conversations/communications that relate to, or are intended to result in, the conclusion of a transaction or the provision of client order services, even if they do not result in transactions/client order services; and “relevant internal” conversations / communications • Regime also applies in respect of corporate finance business, to portfolio management (with the removal of the current qualified exemption for discretionary investment managers) and to collective portfolio managers • Records of conversations/communications must be stored for five years, or seven years at the FCA's request (currently FCA requires records to be kept for six months) • Must also record all information related to relevant face-to-face meetings with clients (e.g. by using written minutes or notes) • More prescriptive organisational requirements • Must notify clients about recording before providing investment services
What are the key impacts?	<ul style="list-style-type: none"> • Identify staff/business areas and types of electronic communications within scope • Review relevant policies and procedures and update for compliance with MiFID II • Ensure clients notified about recording

CASS

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art 13(7)-(8) • CASS 6, 7
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art 16(8)-(9) • Delegated Directive (EU) 2017/593, Art 2-8 • CASS 6, 7
What are the changes?	<p>The FCA already in general applies the MiFID II requirements, so no significant changes:</p> <ul style="list-style-type: none"> • Title Transfer Collateral Arrangements (TTCAs) with retail clients are prohibited. Must assess non-retail client TTCA appropriateness. FCA already bans most retail client TTCAs • Custody liens prohibited except where required under applicable law in a third-country jurisdiction where client's assets are held. Client disclosures must be made. Similar to existing CASS prohibition on custody liens • Firms delegating custody to a sub-custodian must ensure that client assets are deposited in a jurisdiction that regulates and supervises their safekeeping; and are not held in a non-EEA country unless required by the professional client/nature of the assets • Prohibition on depositing over 20% of client money in a group bank, with exemption for small balances (FCA will only offer exemption to CASS small firms) • Must have measures in place to prevent unauthorised use of client assets, e.g. if a client has insufficient assets to settle a transaction • Firms must make internal assessments when considering depositing client money in a qualifying money market fund (QMMF), with reference to credit rating agency ratings; and express consent required from clients to deposit money in a QMMF (slight change from existing CASS requirements)
What are the key impacts?	<ul style="list-style-type: none"> • No major impact to UK firms already subject to CASS 6 and 7 unless TTCA arrangements in place

Corporate governance

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art 9(1) • SYSC 4
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art 9, 16, Recitals 53-55 • Delegated Regulation (EU) 2017/565 Art 21-25 • ESMA and EBA draft guidelines on the assessment of the suitability of members of the management body and key function holders under CRD IV and MiFID II • SYSC 4.3A
What are the changes?	<ul style="list-style-type: none"> • MiFID II extends the more prescriptive corporate governance requirements under Arts. 88 and 91 CRD IV to all MiFID investment firms • The FCA will apply the amended rules under SYSC 4.3A to all common platform firms; key requirements relate to the clear allocation of responsibilities for strategic objectives; risk strategy and internal governance; time commitment and restrictions on numbers of directorships; independence of mind; diversity policy; establishment of a nomination committee (only applicable to significant IFPRU firms) • ESMA/EBA are in the process of finalising joint guidelines to assist firms in the assessment of the individual and collective suitability of their management body / board
What are the key impacts?	<ul style="list-style-type: none"> • Impact here for firms <u>not</u> subject to CRD IV requirements but will be brought within scope of similar governance rules • Need to consider whether new processes and additional documentation are required

Conflicts of interest and remuneration

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 18 • Principle 8, SYSC 10
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 16(3), 23 • Delegated Regulation (EU) 2017/565 Art. 33-35 • Principle 8, SYSC 10, 19F
What are the changes?	<ul style="list-style-type: none"> • The fundamental obligation to identify and manage conflicts remains the same, but firms must now also take all appropriate steps to “prevent” conflicts of interest - new focus on having procedures and measures to prevent conflicts of interest • More extensive requirements for disclosures to clients on conflicts, e.g. must include specific description of any conflicts that arise in the provision of services; must explain the risks to the client and the steps undertaken to mitigate risks • Explicit requirement to identify, prevent or manage conflicts caused by inducements and remuneration or other incentive structures • Must keep a record of the kinds of services carried out by a firm in which a conflict has arisen or may arise; and make annual reports of this to senior management
What are the key impacts?	<ul style="list-style-type: none"> • Need to reassess conflicts of interest arrangements and update conflicts of interest policy, procedures, statement and disclosures to clients • Need to review remuneration of sales desk and other relevant staff to ensure remuneration practices do not impair clients’ interests and are not predominantly based on volume/value of client transactions

Knowledge and competence

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Implementing Directive Art. 5(1)(d) • SYSC 5 and TC
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 25(1) • ESMA Guidelines for the assessment and knowledge of competence • SYSC 5 and TC
What are the changes?	<p>Existing FCA provisions in TC on specific appropriate qualifications will remain unchanged. However, will need to comply with the ESMA Guidelines, which introduce a small number of changes to the existing regime:</p> <ul style="list-style-type: none"> • Firms must ensure that individuals giving investment advice or information about financial instruments or investment/ancillary services to clients possess the necessary knowledge and competence to fulfil their investor protection obligations • Employees must have both an appropriate qualification and appropriate experience (acquired over a minimum period of six months) in order to work unsupervised • Employees must acquire knowledge and competence over a maximum period of four years. During this period they may work under supervision • Requirements will apply to those who provide investment advice to professional clients and employees that give information to retail and professional clients
What are the key impacts?	<ul style="list-style-type: none"> • Review employee knowledge and competence procedures, training schemes etc. and update where necessary for compliance with MiFID II • Consider whether any additional employees need to be compliant with knowledge and competence requirements under MiFID II • Bear in mind additional obligations/changes that will become applicable under the extended SMCR in 2018

Complaints

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Implementing Directive Art. 10 • DISP
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • Delegated Regulation (EU) 2017/565 Art. 26 • DISP 1, 2.3
What are the changes?	<p>Should be aware that:</p> <ul style="list-style-type: none"> • MiFID II complaints handling requirements apply in relation to retail clients, professional clients and ECPs (as opposed to existing MiFID regime (retail clients only) and existing UK regime (“eligible complainants”)) • FOS jurisdiction extended to advice on/sales of structured deposits • FCA will set out the MiFID II requirements separately in DISP 1 • MiFID II complaints handling requirements very similar to existing FCA complaints requirements (e.g. to have a complaints management policy; publish details of complaints handling process; communicate with clients) – so no major impact for firms
What are the key impacts?	<ul style="list-style-type: none"> • Review whether any categories of client and/or areas of business will be brought within the scope of complaints handling requirements • Review complaints policy/procedures and check whether any amendments required

Outsourcing

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID Art. 13(5) • SYSC 8
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art. 16(5), Recitals 43-44 • Delegated Regulation (EU) 2017/565 Art. 30-32, 29(5) • SYSC 8.1
What are the changes?	<p>Minor changes to existing requirements:</p> <ul style="list-style-type: none"> • A firm must ensure a service provider has “sufficient resources” and an “appropriate organisational structure” to support performance of outsourced functions • Must ensure service provider carries out outsourced services in compliance with applicable law and regulatory requirements • Must have methods/procedures for reviewing on an ongoing basis the services provided • Must be able to terminate arrangement for outsourcing where necessary, with immediate effect when this is in the interests of the firm’s clients • Outsourcing agreement must set out the firm’s instruction and termination rights, its rights of information, right to inspections and access to books and premises; and must ensure that sub-outsourcing only takes place with the firm’s written consent • May only outsource functions related to portfolio management to a third-country service provider if (i) service provider is authorised/registered and supervised in its home state and (ii) there is an appropriate co-operation agreement between the firm’s competent authority and the service provider’s supervisory authority
What are the key impacts?	<ul style="list-style-type: none"> • Need to review any outsourcing arrangements for “critical or important operational functions”, or functions related to portfolio management, and check for compliance with MiFID II requirements • Consider territorial impacts and “extension” of MiFID II requirements to non-EEA delegates

Best execution (1)

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID I Article 21; MiFID I Implementing Directive Article 44(3) • COBS 11.2 • CESR Q&A on best execution: http://www.esma.europa.eu/system/files/07_320.pdf
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFID II Art 27 • Delegated Regulation (EU) 2017/565, Art 64-66, Recitals 99-108 • COBS 11.2A, COBS 11 Annex 1EU
What are the changes?	<p>No fundamental change to the best execution regime, but new and more detailed requirements for execution arrangements, information to clients and publication obligations:</p> <ul style="list-style-type: none"> • Firms must take all “sufficient steps” (instead of “reasonable steps”) to obtain the best possible result for clients • Higher bar for compliance – requires more monitoring of quality and appropriateness of execution arrangements and policy • Must take account of own costs for executing orders when selecting venues • Express prohibition on receiving remuneration, discount or non-monetary benefit for routing clients’ orders to a venue which would contravene inducements/conflicts of interests requirements • When executing orders/taking decisions to deal in OTC products including bespoke instruments, must check the fairness of the price proposed to the client

Best execution (2)

REQUIREMENTS	
What are the changes?	<ul style="list-style-type: none">• More detailed information must be provided to clients about execution policy• Must disclose to clients any differences in fees per execution venue; any inducements received from execution venue; and any fees charged by firm to counterparties;• New annual publication requirements: must publish top 5 brokers/executing entities used for each asset class, for retail as well as professional clients; and a summary of analysis and conclusions drawn from monitoring of the quality of execution on venues used• Make use of the increased information available from trading venues (as they must publish quarterly reports of data relating to the quality of execution, covering each trading day)
What are the key impacts?	<ul style="list-style-type: none">• Need to define role - clearly state whether executing or transmitting for execution through other entity• Need to review execution policy and arrangements to ensure meet new higher standard• Need to update information provided to clients with the new details required• Need to publish reports annually – first reports by 30 April 2018, on website• Need to assess if any new systems/processes required for preparing reports• More monitoring of execution arrangements required

Transaction reporting (1)

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID I Art 25(3)-(7); MiFID I Implementing Regulation Art 12(1)(a)-(e) • SUP 17, TRUP 3.1
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFIR Art 26, 50; Delegated Regulation (EU) 2017/590 including Annexes • ESMA Guidelines on Transaction reporting, order record keeping and clock synchronisation under MiFID II (ESMA/2016/1452) • SUP 17A (and we expect TRUP 3.1 to be updated)
What are the changes?	<p>MiFID II substantially extends the scope of reportable transactions and data reported:</p> <ul style="list-style-type: none"> • Transactions executed in financial instruments (FIs) admitted to trading on an MTF or OTF or subject to a request for admission to trading on a venue; and FIs where only the underlying, or a component of the underlying index or basket, is traded on a trading venue are caught • Transactions in commodity, interest rate and FX OTC/listed derivatives potentially within scope • The creation/redemption of units in a collective investment undertaking by the administrator is not reportable (but any sales/purchases in the secondary market following creation are within scope and must be reported) • Number of data fields in transaction reports increased substantially, from 23 to 65 • From 3 January 2018 firms may not execute a trade on behalf of a client who is eligible for a Legal Entity Identifier (LEI) and does not have one • Can report through an ARM, through a trading venue or directly to FCA • More detailed, extensive systems and controls requirements, e.g. must promptly notify FCA of an error/omission in any transaction report; a failure to submit a report; or the reporting of a transaction that is not reportable • Indication is that over-reporting must be limited as far as possible; and the FCA will no longer permit it to such an extent as it has previously

Transaction reporting (2)

REQUIREMENTS	
What are the changes?	<ul style="list-style-type: none"> • Firms that are members or participants of trading venues must synchronise their business clocks used to record the date and time of reportable events • Current regime allowing portfolio managers to rely on their executing brokers to make transaction reports in certain circumstances is, under MiFID II, replaced with a new, more limited regime – the exemption for transmission of orders • A firm that transmits orders to a broker will be deemed not to have executed a transaction (and therefore will have no transaction reporting obligation) provided: <ol style="list-style-type: none"> 1. The order for transmission was received from the firm’s client or is the result of an investment decision taken in accordance with a client discretionary mandate; 2. The transmitting firm transmits all the required order details to the broker; 3. The broker is subject to transaction reporting requirements and agrees to report the transaction or to transmit the order details to another receiving firm; and 4. The transmitting firm and broker have a written agreement in place which specifies the time limit for the provision of the order details to the broker and confirms that the broker will validate the order details received for any obvious errors/omissions before submitting a transaction report. • Alternatively, a transmitting firm must submit its own transaction report including details of the resulting transaction and confirming that it pertains to a transmitted order
What are the key impacts?	<ul style="list-style-type: none"> • Must ensure all reportable transactions are captured – but limited impact where transaction concerns the creation/redemption of units through the administrator • Need to ensure have necessary systems, processes and information flows to capture the new details required for transaction reports • May need to contact clients to obtain details including LEI • Review arrangements with brokers and ensure necessary agreement and arrangements in place if wish to rely on them for transaction reporting • Expect more portfolio managers will carry out their own transaction reporting

Post-trade transparency

REQUIREMENTS	
Where are the current rules?	<ul style="list-style-type: none"> • MiFID I Art. 28 • MAR 7
Where are the rules under MiFID II?	<ul style="list-style-type: none"> • MiFIR Art. 20,21 • Delegated Regulation (EU) 2017/583, Delegated Regulation (EU) 2017/587
What are the changes?	<ul style="list-style-type: none"> • MiFID II expands the post-trade transparency regime to additional instruments (equity-like instruments – e.g. depositary receipts, ETFs and certificates; and non-equities – e.g. bonds, structured finance products and derivatives, traded on an RM, MTF or OTF), as well as equities • Where a firm has executed transactions in an applicable instrument outside the rules of a trading venue, on own account or on behalf of clients, the firm will be subject to post-trade transparency obligations (i.e. to make public data about the transaction) • Must also provide transparency in relation to transactions concluded on third-country venue not subject to certain level of post-trade transparency (ESMA intends to publish list of such third-country venues) • Reports should be made through an Approved Publication Arrangement (an APA) • Only the seller must make the report for an off-venue transaction, unless one party is an SI
What are the key impacts?	<ul style="list-style-type: none"> • If firm executes transactions outside a trading venue in a relevant instrument, it will be subject to post-trade transparency obligations and so will need to make arrangements with an APA to report the post-trade information; and ensure it has systems and processes in place to collect the required information • Firms may benefit from more trade information being published by other firms and operators of trading venues as a result of the expanded pre- and post-trade transparency requirements

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